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Prospective Changes in the Price Level

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FROM 1850 to 1914 there were three major price movements. During the first period, which extended to 1873, prices rose. This period was followed by a decline in prices from 1873 to 1895. The third period began with an upward trend in 1896 which was still continuing at the outbreak of the European War in 1914. These three movements were not confined to the United States, but were world wide. In every country they started at approximately the same date, progressed at nearly the same rate and came to an end at about the same time. In 1914, the upward movement was still in progress with no indication of a reaction yet visible.

There is no occasion here to discuss the causes of these changes further than to state the somewhat general belief that they were the result of a fluctuating gold production. The discoveries in California, beginning in 1849, gave an annual output that became larger and larger until 1873. Then it declined somewhat for a number of years, only to increase again in the late eighties under the stimulus of new discoveries, and improved methods of extracting the gold from the ore, these changes beginning to have an effect on the price level by 1896.

Another movement began in 1914 and is still continuing at the time this is written. Rapid as was the rise of prices during the eighteen years following 1896, it seems slow when compared

with the changes of the past five or six years. Its causes are amply considered elsewhere in this volume of *The Annals*, and we need only observe that they are a combination of large issues of paper money by banks and governments, an increase of the deposit liabilities of the banks and a considerable scarcity of many kinds of commodities.

CONSEQUENCES OF PRICE CHANGES

These various changes have had serious consequences. During the period from 1873 to 1895 there was great hardship among those groups who had obligated themselves to pay each year fixed sums of money, but whose receipts from products sold were constantly less as prices fell. Imagine a farmer who had assumed a \$10,000 mortgage in 1870, expecting to pay it off at the end of ten years and maintain interest obligations in the interval. In 1873, prices began to fall, and as the years passed the farmer received less per bushel for his products. Larger and larger quantities of grain were needed to meet the interest on his mortgage and to accumulate a sinking fund with which to pay the principal.

In this same period, creditors were constantly better off. Receiving each year fixed sums of money, they could buy more and more commodities as prices fell. As they were not experiencing any hardship they did not complain and even found it hard to

sympathize with the farmer and other debtors. Since the people of the west and the south were predominantly debtors in this period, it is not surprising to discover that they anxiously sought for a remedy. Rightly or wrongly, they thought it would be found in an increased volume of circulating medium and urged that such increases be secured by issues of government paper and by a return to bimetallism.

In the north and east, there were fewer debtors, but more creditors who owned bonds and mortgages on the properties of the south and west. These creditors, whose status was constantly improving through the fall in prices, were quite content with the situation and opposed to the demands of the bimetallists. For about twenty years, the two groups struggled for supremacy, the climax coming in the victory of McKinley over Bryan in the presidential campaign of 1896. After that date conditions were reversed; prices rose and debtors ceased to feel the pressure which was shifted to those classes in the country who were the recipients of relatively fixed incomes—wage earners, the salaried groups and those who were living on the incomes from their investments. The hardships of these groups were serious prior to 1914, but since that time have become even more acute.

Just how great this change has been in the United States is indicated by the index numbers of the United States Bureau of Labor. Accepting the price levels of 1913 as our starting point or 100, the increase of wholesale commodity prices was to 248, and of retail food prices to 201 for January, 1920. Prices of these commodities

are thus from two to two and one-half times as high as in 1913. These increases actually did not begin (in the United States) until September, 1915, when the level was about the same as in January, 1913.

HIGH AND LOW VERSUS RISING AND FALLING PRICES

Before passing to an analysis of the situation now confronting the world, it is important to point out that there is no special reason for concern over either high prices or low prices. High and low in any connection are merely relative terms, and are used here only to compare prices at a given time with those at some other time. If some level—high or low or intermediate as compared with the past—could be accepted and retained our troubles would be lessened. After a time, those prices, wages and salaries which were distinctly out of line would adjust themselves to the adopted level. Neither high prices nor low prices are a cause for concern. Rising prices and falling prices cause the trouble and stabilization is the important thing.

STABILIZATION OF PRICES

There are several alternatives before the world at present. As usual, one possibility is to do nothing, to let matters drift. Of course, by doing nothing one actually decides to face the results of certain very definite tendencies, but the activity of numerous propagandists indicates an unwillingness to take a *laissez-faire* attitude. Let us then suppose that it is actually possible for us to exercise conscious control over price movements. Let us further assume that it is our plan to

accept some price level as suitable, to adjust prices accordingly and then attempt to stabilize prices at this level. What level would we approve and what arguments could be advanced in its favor?

Positive suggestions divide themselves into two groups: one set of arguments being advanced to support the idea that the present price level should be maintained, the other that it should be lowered.

Much may be said in favor of checking any further rise in prices and of maintaining them as near the present level as possible. As has just been pointed out, high prices are not in themselves objectionable. It is changing prices that are troublesome. Why not stabilize at the present level? Or even if one doubts the possibility of stabilization, why not at least avoid any great amount of deflation? Such a policy, if practicable, would save us from the difficulties that there are in falling prices, in the transition from our present level to a lower one. Such a fall would repeat the hardships of the period from 1873 to 1895, and would perhaps be even worse, especially if the new level is to be much lower than the present one and to be attained in a short period of time. Why not endeavor to hold the present level? After a time, those prices and incomes which have lagged behind during the upward trend will catch up and with far less hardship in the community than would accompany falling prices.

This view is supported by our consideration for those who have been forced to borrow at the high price level. If prices now fall, they will suffer precisely as did the farmer who

had mortgaged his farm at the high price level prevailing prior to 1873. In the last few years, both individuals and corporations have borrowed heavily. If the price level declines some of their expenses, as those for wages and raw materials, may go down, but not their obligations to repay fixed sums with interest at a fixed rate until maturity.

But the situation is worse than in 1873. Prices are much higher than at that date and if the return is to a level at all near that of 1914, the hardship will be very great. Moreover, there has entered into the situation a serious complication in the form of a mass of government obligations. The increase in the public debts of the principal belligerents during the war was over \$200,000,000,000 with an addition to their annual debt charges of over \$8,000,000,000. Nor does this include the new debts of any but the central governments. States, municipalities and other political divisions are not included nor are the debts of neutral countries.

What would be the effect on these governments of a lowered price level? Assume that there is a certain manufacturer of cotton cloth in Great Britain whose appropriate share of the annual tax burden is £10,000. Buying his raw materials and paying wages at the present level means a heavy outlay, but selling at present prices he can pay the £10,000 to the government, although he could not pay a higher tax.

Assume that his selling price falls to 50 per cent of the present level. Make also the unreal assumption that all his expenses will fall correspondingly and that his percentage gain will be

as great as at present. Still it will be less in dollars and he will no longer be able to pay £10,000 per annum. But the government's expenditures for debt service will not go down with the general fall in prices. That charge is for a given amount in pounds sterling and failure to pay it means default. A falling price level will add enormously to the fiscal problems of all the leading governments of the world.

There seem to be strong reasons for endeavoring to maintain the present price level, but there are also serious difficulties. Hard as it would be to descend to a lower scale, there are still many prices not up to the high level of some, while most wages and salaries are still lagging far behind. This lag means suffering and discontent and is probably the chief cause of the current industrial unrest.

Another complication is the great danger that the leading banks may at any time find themselves unable to meet the demands made upon them. Note issues and deposit liabilities have expanded greatly. Although gold holdings have in some banking systems been increased, these gains have not been sufficient to maintain the old reserve ratio. The Bank of England, which formerly kept a reserve of about 45 per cent, now has only about one-half that amount. The Bank of France has fallen from between 50 and 60 per cent to between 10 and 20 per cent, while the Bank of Germany has dropped from nearly 60 per cent to less than 3 per cent. Perhaps the former percentages were in a few cases unnecessarily high, but some of the present ones are dangerously small. If the liabilities are not reduced or the

gold base increased, there is danger of a collapse at any time.

Increasing the gold base is by no means easy. The larger part of the gold in private hands was concentrated in the banks during the war and any amounts still out will be very hard to collect. At the same time, the output from the mines has greatly fallen off. The so-called "price" of gold per ounce is necessarily fixed and is, in the United States, \$20.67 per ounce of pure gold. With this selling price fixed and costs of materials and wages rising, the poorer mines are quickly placed at a disadvantage. Many of them have shut down and the annual output of gold has decreased.

This decline in gold output has led to many suggestions for encouraging the industry. It has been suggested, for example, that the mint price of gold be increased to say \$30 per ounce, a plan that would merely mean coining each ounce into fewer dollars and putting into circulation dollars of lighter weight than before. This would, of course, disturb prices further, driving them still higher than at present. If the weight of the dollars was not decreased the difference of \$10 per ounce would have to be met from the general funds of the treasury and would call for heavier taxation. Subsidies are not usually popular and are apt to be less so when governments are so heavily burdened as at present.

Another proposal is to increase the metallic base behind these note issues and deposits by adding silver to the gold,—in other words, by adopting bimetallism. It is curious to notice the respectful attention given to such a plan in some quarters where, thirty years ago, bimetallism was regarded

as the rankest of heresies. Many who fear a collapse of the credit structure of today will listen sympathetically to a discussion which they would not have endured at that time. As yet the proposal has not taken very concrete form, except for the suggestion of an international conference on the subject. If silver should fall from its present price of from \$1.20 to \$1.30 per ounce, the silver interests would probably become more active in their advocacy of the plan. The difficulties of increasing the metallic base behind these obligations, either with silver or with gold, is so great that a reduction in the obligations themselves seems the more probable.

Still another consideration is the strong popular criticism of high prices. Public opinion is strongly in favor of a reduction. A lowered price level has very definite attractions. Having to pay more than formerly for all purchases one is apt to enthuse over the prospect of a lower level. Hence the popularity of deflation. Most of us do not think that our incomes have gone up as much as the prices of the articles we buy, and contend that we are the losers. Similarly we do not always include our own incomes among the items that will fall if the general price level should be lowered. Those of us who are correct in this view may personally gain from deflation, but those whose incomes fall more rapidly than the prices of other things may lose.

On the whole, the forces that will operate to check the upward movement are the more powerful and a reduction seems certain. With it will

come the customary business failures, unemployment and suffering, complicated by increasing difficulties for governments who will find it harder and harder to meet their obligations. The longer the ordeal is postponed, the worse it will be when it comes. The higher we mount the farther we shall fall and the greater the disaster. Stabilization of prices at some level is perhaps the most important problem facing us for solution. Whether it is feasible may be open to argument but in any case, stabilization at the present level is unwise and impossible.

This does not mean a return at once to the pre-war level. Since 1914 numerous changes, many of which are permanent, have occurred. In England the gold coins have been concentrated in the banks, their place in the circulation being taken chiefly by the currency notes. In the United States a similar change has occurred, the gold coins and gold certificates having been collected by the Federal reserve banks. Federal reserve notes and federal reserve bank notes have taken their place. Paper money issued by governments and by banks has displaced the gold and the public seems to be reconciled to the change. The volume of paper money is doubtless too large at present but each dollar of gold in the vaults of the banks will support several times its face value of paper money and deposits. The net result will be a larger volume of circulating medium than before and in the absence of a greatly increased production we may expect a price level higher than that before the war although not so high as at present.